SUPREME COURT, U. S.
OCT 15 1974
MICHAEL RODAK, JR., CLE

No. 74-124

In The

SUPREME COURT OF THE UNITED STATES

October Term, 1974

Blue Chip Stamps, et al.,

Petitioners,

v.

MANOR DRUG STORES, On Behalf of Itself and All Other Users of Blue Chip Stamps Who Were Entitled But Failed to Purchase Stock of Blue Chip Stamps

Respondent.

OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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No. 71-2223

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OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Respondent files this opposing brief under Supreme Court Rule 24 and prays that this Court deny the Petition for Writ of Certiorari to review the decision of the United States Court of Appeals for the Ninth Circuit, which reversed a decision

of the United States District Court for the Central District of California dismissing Respondent's First Amended Complaint.

OPINIONS BELOW

The opinion of the court of appeals, as modified, is reported at 492 F. 2d 136 and appended to the petition as Appendix A. The order denying petitions for a rehearing in banc before the Ninth Circuit with certain modifications of the court of appeals opinion is set forth in Appendix B to the petition. The decision of the district court is found at 339 F. Supp. 35 and in Appendix C of the petition.

QUESTIONS PRESENTED

1. Do Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5 of the Securities and Exchange Commission deny standing in a civil damage action to a plaintiff who has a right or entitlement to purchase

securities but is deprived of exercising said right or entitlement because of the fraud of the offeror?

2. The decision below does not deal with the question of whether an amicus curiae may enforce a Consent Decree, nor with the policy and intent of the Securities Act of 1933.

STATUTORY PROVISIONS

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), provides in pertinent part:

> "§ 78j. Manipulative and deceptive devices
>
> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, of any facility of any national securities exchange--

". . . .

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated by the Securities and Exchange Commission, provides as follows:

"§ 240.10b-5 Employment of manipulative and deceptive devices.

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate

commerce, or of the mails or of any facility of any national securities exchange,

"(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security."

STATEMENT OF THE CASE

This is an action, based upon a unique set of

facts, for damages under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78 j(b), and Rule 10(b)-5 promulgated thereunder, 17 C.F. R. §240.10(b)-5. After dismissal of its complaint upon the grounds that plaintiff lacked standing to sue under Section 10(b), respondent appealed to the Ninth Circuit Court of Appeals. The appellate court in a 2-1 decision reversed the district court and remanded the case for further proceedings. The rationale of the Ninth Circuit was that the plaintiff, although technically not a purchaser or seller, nevertheless, could maintain an action under §10 (b) since it enjoyed a right, equivalent to that flowing from a contractual relationship, to purchase securities of the defendant corporation.

1. Relevant Facts Preceding The Filing Of This Action.

In order to highlight the singularity of the facts in the case at bar and to provide an essential and informative background for the institution

of the present action, it is necessary that respondent set forth certain facts and circumstances which precipitated the litigation at bar.

As a result of various alleged violations of the Sherman Anti-Trust Act, the United States government filed a civil anti-trust action against the defendants, Blue Chip Stamp Company and all of the other corporate defendants named herein. (R. at 4; App. E at E-5.)

Prior to a consent decree being entered in 1967 (R. at 21), the district court permitted entry into the anti-trust litigation by several amici curiae, including the California State Attorney General, the California Grocers Association and Certified Grocers of California, Ltd., each of which included within their constituency a substantial portion of the Users herein (it should be clarified at this point that the Users, plaintiffs herein, are comprised of the various retailers who issued Blue Chip stamps to consumers as a reward for their patronage). A significant facet

of the Consent Decree which was finally entered concerned a reorganization of Blue Chip Stamp Company into the presently constituted Blue Chip Stamps. No less than three reorganization plans were submitted to the district court. The avowed purpose of each such plan was to effectuate the divestment of the corporate defendants of their stock holdings in Blue Chip Stamp Company and to atone for the attempted defeasement of the equitable ownership in Blue Chip Stamp Company as urged by the Users through the amici curiae. As not just indicative, but conclusive, of the clear purport of the reorganization plan which was eventually approved by the court, the following is offered.[1]

---

[1] The quotations which follow are derived from the official records and documents filed with the district court in the anti-trust action. The pertinent portions of these records and documents were presented to the Ninth Circuit Court of Appeals in Plaintiff-Appellant's Supplemental Brief, attached hereto as Appendix A. The salient portions thereof were reviewed and considered by the Ninth Circuit

These verified statements demonstrate that the fears expressed by the dissenting opinion below and petitioners herein are not only ill-founded, but contrary to what was intended by the parties and the court in agreeing to the eventual Consent Decree:

> ". . . Blue Chip's present net assets . . . should be regarded as beneficially belonging in proportion to their patronage, to all retailers who made it what it is today." (App. A hereto at pp. 8-9; Brief of the State of California As Amicus Curiae, filed November 15, 1966, p. 77, ll. 10-12.)

> "From its inception, Blue Chip was promoted as being run for the benefit of the

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Court of Appeals and were relied upon in part as a basis for its decision. (See Opinion, Footnote 4, App. A of Petition, p. A-3.)

users whose help was enlisted in its promotion.

"The consenting parties have not addressed any comments to this point. However, much as they would, they cannot close their eyes to the role of the non-defendant users and their very real equity in Blue Chip, its name, its good will and the value of its established business.

"The rights of thousands of California merchants relate not only to the unpaid patronage dividends but also to the other more valuable assets of Blue Chip. So long as any settlement of this case fails to recognize these rights of non-defendant users, the required determination that such settlement is equitable and in the public interest cannot be made." (emphasis ours) (App. A herein at pp. 10-11;

Reply Brief of California Grocers Association And Certified Grocers Of California, Ltd., As Amicus Curiae, pp. 12-15, filed December 5, 1966.)

In seeking Court approval of the Reorganization Plan and in defense of their "bargain offering" to the Users the defendants stated:

". . . The Reorganization Plan has two basic purposes and objectives, namely . . . (2) to compromise disputed claims which had been asserted by representatives of California Grocers' Association, Certified Grocers, and others on behalf of non-stockholder users . . . It became apparent that such settlement could not be achieved without offering non-stockholder users an opportunity to acquire an equity interest at a price sub-

stantially equivalent to that originally paid by the present stockholders. " (emphasis ours) (App. A at p. 15; Reply To Memorandum of Raley's Inc. In Opposition To Motion Of Defendants For An Order Approving The Plan of Blue Chip Stamp Company Lodged With the Court August 3, 1967, p. 7. ll. 7-18, filed August 22, 1967.)

If there be any doubt that the Court, too, recognized this equitable interest in the Users and intended that it be accounted for in the Consent Decree, such doubt is allayed by the Court's following statement:

" The decree herein is designed to limit the powers of Blue Chip and to open up and increase competition in the stamp industry in California, while at the same time preserving the legitimate interests

of the users of Blue Chip Stamps. (emphasis ours) (App. A at p. 16; Order Denying Motions To Intervene And To Vacate Consent Decree, p. 18, ll. 6-10, entered August 8, 1967.)

In a hearing subsequent to Court approval of the Consent Decree and Plan of Reorganization, Mr. William W. Alsup, on behalf of Blue Chip Stamps, conceded that the "Users" were intended to be benefitted by the Consent Decree and Plan of reorganization thereunder:

"Mr. ALSUP: We do think we need a hearing date obviously to go into the question of who of these users are entitled to subscribe, assuming Mr. Raley and his group are not, and we take care of these users, as was intended." (emphasis ours) (App. at p. 16; Reporter's Transcript Of Proceedings, Monday, Nov-

ember 4, 1968, Thursday, November 7, 1968, p. 12, ll. 8-12.)

At a hearing subsequent to approval of the reorganization plan, Mr. Wallace Howland on behalf of the State Attorney General sounded almost as if he had the present litigation in mind when he addressed the Court as follows:

"Mr. HOWLAND: So what we have here, if the court please, is a right, a legally cognizable right conferred upon the user by the plan of reorganization approved by order of this court. It was a right, in effect, to compel Blue Chip Stamp Company to issue its units to a user, and it was a right that each user could either exercise or waive in his discretion." (emphasis ours) (App. A at p. 20; Reporter's Transcript of Proceedings, Monday, November 4, 1968, Thursday

November 7, 1968, pp. 42-43.)

2. Allegations Of The Complaint.

As stated above, a Consent Decree was approved and entered in the aforementioned antitrust litigation, a material portion of which was the reorganization plan. Such plan provided, in pertinent part, as follows:

> "An offering of approximately 621, 600 shares of its common stock would then be made by New Company (defendant BLUE CHIP STAMPS) to users of BLUE CHIP STAMPS (who issue stamps to their retail customers as a reward for patronage) other than users who are also shareholders of BLUE CHIP (such users to whom such offering is to be made are hereinafter referred to as 'Users') on a pro rata basis determined by the quantity of stamp pads issued to Users during the period subsequent to

March 1, 1964, and prior to a date to be determined which will be not more than ninety (90) days prior to the effective date of registration statement hereinafter referred to. The offering will be made in units consisting of three (3) shares of the common stock of New Company (defendant BLUE CHIP STAMPS) and one (1) One Hundred Dollars ($100.00) principal amount debenture for a cash consideration of One Hundred and One Dollars ($101.00)." (R. at pp. 22-23; App. E of Petition, p. E-6.)

The Consent Decree further provided that those shares which were not purchased by the Users under the offering above could be sold by the defendants to the public at their then current market value. (R. at p. 23.)

In 1968, the defendants, in connection with the required offering, mailed to the Users various

documents, including a prospectus dated August 29, 1968. It is alleged that said prospectus grossly misrepresented the true value of the offered shares of Blue Chip Stamps and unjustifiably denegrated the then present and future financial condition and prospects of said company. This "negative prospectus" was the embodiment of a fraudulent scheme of the defendants to dissuade the Users from exercising their rights to purchase said shares at a "bargain price" ($8.67), to the end that the defendants could sell the unsubscribed shares on the open market at their then market value ($90.00 per share). (R. at pp. 25-30.)

As a result of these misleading and fraudulent practices of the defendants, many of the Users, including the plaintiffs herein, were dissuaded from exercising their rights in purchasing the offered shares.

Approximately one year later, the defendants offered shares of Blue Chip Stamps to the general public at a price of $90.00 per share. This general offering was accompanied by a new and different prospectus (R. 107) which differed materially and substantially from the "negative prospectus" distributed to the Users, although the negative elements emphasized in the "negative prospectus" would have been as relevant, if true, to the offering made to the general public a year later. (R. at pp. 27-30; App. E at pp. E-11 to 14.)

The alleged distinction in the Petition that the shares which were sold a year later were not the identical shares offered to the Users is irrelevant. The thrust of the aforesaid allegations

is to demonstrate that those shares which were required to be offered to the Users were to be at a "bargain price" and it is unimportant whether those offered to the Users, or those retained by the corporate shareholders, were the identical securities sold at a later date on the public market for a considerably higher price. The crux of these allegations is that the offering that was required to be made to the Users was to be at "bargain price", because of the equitable ownership of the Users in Blue Chip Stamp Company.

The Reorganization Plan required that Blue Chip Stamps offer 621,600 shares of its common stock to the Users. (R. at p. 22; App. E of Petition, p. E-6.)

Based upon a formula calculated upon the number of stamp pads purchased by the Users, each offeree would be entitled to subscribe to units consisting of three shares of the new Company, Blue Chip Stamps, and a six and one-half per-

cent subordinated debenture for the purchase price of One Hundred and One Dollars ($101.00). This purchase price was intended to be and was, in fact, a bargain (R. at pp. 23-24). The aforesaid units were reasonably worth Three Hundred and Fifteen Dollars ($315.00) at the time of the offering. (R. at pp. 24-25.)

In connection with the required offering of said shares to the Users, the defendants caused to be published a prospectus (R. at pp. 70-106). The defendants, however, did not want the Users to exercise their rights under said offering (R. at p. 25) for the reason that the price at which the shares were offered to the Users was a bargain and the defendants had the right under the Plan to sell unsubscribed shares at a more truly fair market value. (R. at pp. 27-28.)

Within a year after the offering to the Users, certain of the defendants offered to the public (R. at pp. 25-27.) over 300,000 of the original shares shares at a price of Ninety Dollars ($90.00) per share.

The required prospectus in connection with the offering to the Users highlighted and emphasized five items of special interest of a negative character which were thereafter referred to individually or collectively within said prospectus approximately fifteen different times. (R. at p. 27.) When the defendants themselves, one year later, offered their own shares to the general public, a different prospectus (R. at pp. 27-28) was published which contained no such negative items of special interest, although to the extent that they were relevant at the time of the offering to the Users, they were relevant at the time of the later prospectus. (R. at p. 28.)

The dichotomy between the aforesaid prospectuses was the product of a fraudulent scheme by the defendants to discourage the respondents herein from exercising their right to purchase said shares at a bargain price in order that the defendants could realize a sale upon the public

market of their shares at a premium price and thus avert the intended purpose of the aforementioned Consent Deecree. (R. at p. 25.)

The respondents herein represent those Users who, as a result of the fraudulent schemes and practices of the defendants, were dissuaded from exercising their right to purchase shares in new Blue Chip.[2] (R. at pp. 30-31.)

ARGUMENT

1. Do Section 10(b) Of The Securities Exchange Act Of 1934, 15 U.S.C. 78j(b), And Rule 10b-5 Of Tthe Securities And Exchange Commission Deny Standing In A Civil Damage Action to A

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[2] Any argument that the offering to the Users was not intended to be or was not, in fact, a "bargain" ignores the clear language of the complaint herein. (R. at p. 24; App. E of Petition at p. E-8.) It is further alleged that the price of the shares offered to the Users was $8.67 per share (R. at p. 31; App. E of Petition at p. E-15) and that the shares which were offered to the general public a year later were at price of $90.00 per share (R. at p. 28; App. E of Petition at p. E-12.)

Plaintiff Who Has A Right Or Entitlement To Purchase Securities But Is Deprived Of Exercising Said Right Or Entitlement Because Of The Fraud Of Tthe Offeror?

It cannot be over-stressed that the facts in the present case present a situation unlike any other with which a court in determining standing under section 10(b) and rule 10b-5 has had to wrestle. Succinctly stated, we have here the anomalous circumstance wherein a defendant under the mandate of a court decree must offer, to a specified class, securities at a bargain price, yet which offering, for reasons of its own monetary gain the defendant hopes and attempts to insure through its fraud will be unsuccessful.

Petitioners have prayed that this Court review the opinion below because it allegedly conflicts with decisions in the Second, Third, Fifth, Sixth, and Eighth Circuit. In so urging, Petitioners fail to recognize the unique facts and cir-

cumstances in the present case and misunderstand the holding in the present case.

The Securities Act of 1933, 15 U.S.C. § 77a, et seq., and the Securities Exchange Act of 1934, 15 U.S.C. § 78a, et seq., were enacted in part to restore the public's confidence in the stock market following the public investment frauds of the 1920's and the market crash of 1929. Rule 10b-5 was promulgated as a broad anti-fraud provision, designed to reach a wide scope of deceptive activities in Securities transactions. Ever since the decision in Birnbaum v. Newport Steel Corp., 193 Fed. 2d 461 (2d Cir. 1952), cert. den. 343 U.S. 956, 72 S.Ct. 1051, 96 L.Ed 1356 (1952), courts have employed various rationales in attempting to retreat from what was believed to be the highly technical and restrictive rule of the Birnbaum case. It had long been felt that the Birnbaum interpretation of the language of section 10(b) and rule 10b-5 language " in connection

with the purchase or sale of any security" required that there must be an actual purchase or sale before standing could be granted to an aggrieved plaintiff in a civil action under the Act of 1934.

Soon, however, the courts began to recognize the inequity in denying such standing to parties who were clearly within that class of persons intended to be protected by securities legislation.

Thus, even though there had been no purchase or sale effected, the courts in examing facts and circumstances of each case have granted standing, for instance, in cases where plaintiffs had found themselves in the position of being a "forced seller" in the future,[3] where the only

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3 Vine v. Beneficial Financial Company, 374 F.2d 627, cert. denied, 389 U.S. 970 (1970); Dasho v. Susquehanna Corp., 380 F.2d 262

transaction had been a corporate merger[4] or issuance by a corporation of its own shares,[5] where the plaintiff was a stock brokerage firm which had ordered securities for which customers later refused to pay[6], and where plaintiffs had unwittingly purchased non-existent stock.[7]

(7th Cir. 1967); Mader v. Armel, 402 F. 2d 158 (6th Cir. 1968), cert. denied, 394 U.S. 940 (1969).

4 Coffee v. Permian Corp., 434 F. 2d 383 (5th Cir. 1970).

5 Hooper v. Mountain States Securities Corp., 282 F. 2d 195 (5th Cir. 1960), cert. denied, 365 U.S. 814 (1961); Ruckle v. Roto American Corp., 339 F. 2d 24 (2d Cir. 1964); Schoenbaum v. Firstbrook, 405 F. 2d 215 (2d Cir. 1968), cert. denied, 395 U.S. 906 (1969).

6 A. T. Brod & Co. v. Perlow, 375 F. 2d 393 (2d Cir. 1967).

7 Goodman v. H. Hentz & Co., 265 F. Supp. 440 (N. D. Ill. 1967).

While here we have the situation where the plaintiffs were dissuaded from purchasing securities to which they were entitled, in Stockwell v. Reynolds & Co., 252 F. Supp. 215 (S. D. N. Y. 1956), the plaintiffs were granted standing under section 10(b) where they had been dissuaded from selling their shares.

These judicial interpretations of the purchase or sale language of §10(b) and their manifest trend toward extending the scope of plaintiffs are consistent with the view expressed by this Court in Superintendent of Insurance v. Bankers Life & Casualty Co., 404 U. S. 6, 12 (1971):

> "Section 10(b) must be read flexibly, not technically and restrictively."

In each case the plaintiff must demonstrate its membership in the "special class" protected by Rule 10b-5. (Eason v. General Motors Acceptance Corp., 490 F. 2d 654, 660 (7th Cir. 1973). The court below performed this test, not-

ing that a common link exists in the cases, as cited above, which have granted standing to non-purchasing or non-selling plaintiffs. That common link is "the existence of a contractual relationship between the parties". (App. A of Petition at p. A-10; App. B of Petition at p. B-2.) Whether plaintiff's right to purchase the subject shares emanated from a contract, a Consent Decree or other relationship, the central issue is whether that relationship brings the plaintiff within the umbrella of Section 10(b) coverage. In the case at bar it clearly did.

Petitioners contend that the Third, Fifth, Sixth, and Eighth Circuits have steadfastly refused to permit standing to one who is neither a purchaser, nor a seller. Respondent takes issue with that claim. Petitioners misread the rule of the Birnbaum case as it has become to be defined. The plaintiffs in that case sought redress under Section 10(b) for internal corporate mismanagement. They were, in no sense, purchasers, sel-

lers, offerors, or offerees. They enjoyed no unique relationship with the defendant which could be said to be within the class of persons that Congress had intended that the Act protect. Despite declarations to the contrary, Birnbaum simply stands for the proposition that Section 10(b) is not the proper vehicle in a civil damages action for the correction of internal corporate mismanagement. (See, Bankers Life, supra, at p. 12.)

Thus, the Sixth Circuit case, Simmons v. Wolfson, 428 F. 2d 455 (1970), which petitioners cite as authority for their position is merely a reiteration of the limited holding in Birnbaum concerning the type of fraud covered by §10(b). In Simmons, as in Birnbaum, the plaintiffs alleged fraud on the part of corporate officers and directors and sought damages through Section 10 (b). The court refused to grant standing to plaintiffs, holding, consistent with the true holding in Birnbaum:

"In our opinion, adoption of appellants'

contention . . . would open the door to federal jurisdiction in claims for damages against corporate directors and officers arising out of breach of their fiduciary duties." (428 F. 2d at p. 456.)

Moreover, in a recent Sixth Circuit opinion, James v. Gerber Products, Co., 483 F. 2d 944 (1973), the court expressly acknowledged the limited application of Birnbaum:

"We view Birnbaum's import as denying shareholders a federal courtroom to litigate all matters of alleged corporate fraud under the auspices of Rule 10b-5." (483 F. 2d at p. 949.)

Landy v. Federal Deposit Insurance Corp., 486 F. 2d 139 (3rd Cir. 1973) and Sargent v. Genesco, 492 F. 2d 750 (5th Cir. 1974), relied upon by petitioners (Petition at p. 15), both present facts clearly distinguishable from the case at bar. In Landy the plaintiffs complained of fraud

committed by the former president of a now insolvent bank who had abused his position as an officer and misused funds of the bank in order to participate in various securites transactions totalling over Two Hundred Million Dollars. The plaintiffs, shareholders of the bank, were unable to state a claim under §10(b) because they simply had not engaged in any fashion in those securities transactions. (486 F. 2d at p. 158.) It was clear to the court that what they really sought was relief under §10(b) for corporate mismanagement. These circumstances are to be contrasted with those present in the instant case. There is no issue in our case concerning corporate mismanagement, nor is there any doubt that the present plaintiffs possess the requisite nexus between the injury which they suffered and the fraud employed by the defendants in connection with its offering and sale of the subject securities.

Similarly, in the Sargent case, the plaintiff-shareholders were unable to show that they

had "been involved in an actual purchase or sale of stocks in connection with the conduct" alleged to be violative of § 10(b). (492 F. 2d at p. 762.) The plaintiffs had already been shareholders when there occurred the fraud as alleged. Although the value of their stock had undoubtedly suffered greatly, their initial purchase of securities bore no rational connection to the later perpetrated fraud.

The Eighth Circuit case relied upon by petitioners suffers from the same defect. In Erling v. Powell, 429 F. 2d 795 (1970), the plaintiff-shareholders complained of fraud by majority shareholders in connection with a sale by the latter of a large block of stock to a third party. The plaintiffs had no connection whatsoever with this transaction, except to the extent that their own holdings were depressed. The plaintiffs were not purchasers or sellers of securities, nor did they, contrary to the case at bar, have any right or entitlement to participate in the subject trans-

actions. As correctly summarized by the court, the plaintiffs' claim merely rested "upon an alleged breach of fiduciary duty owed the corporation and other shareholders". (429 F. 2d at p. 800.)

In a case which presented the other side of the coin of the instant case, the Eighth Circuit granted standing to plaintiffs who had been induced to "hold" their shares, rather than sell them. (Travis v. Anthes Imperial Limited, 473 F. 2d 515 (1973), citing with approval Stockwell v. Reynolds & Co., supra.)

While the Second Circuit has been the most conservative in refusing to vary from the strict construction of the purchaser-seller requirement, these are signs that it, too, recognizes the need for a case by case analysis in determining the issue of standing.

> "The purchase-sale requirement must be interpreted so that the broad design of

the Exchange Act, to prevent inequitable and unfair practices . . . is not frustrated by the use of novel or atypical transactions . . . 'In determining who has standing to enforce duties created by statute, a court's quest must be for what will best accomplish the purposes of the legislature.'" (Crane Company v. Westinghouse Air Brake Company, 419 F. 2d 787, 798 (2nd Cir. 1969).)

The case of Haberman v. Murchison, 468 F. 2d 1305 (2d Cir. 1972), cited by petitioners at page 14 of their petition, has no application to the issue before this Court.

There, as in other cases which have been discussed herein, the plaintiff cited as fraudulent a sale by corporate officers and directors of stock to a third party. Again, plaintiff had no transactional connection or "right" in the subject sale. Because this link to the fraud was lacking,

the complaint under section 10(b) was dismissed. Again, this actual grievance pertained to internal corporate mismanagement, the one type of §10(b) claim clearly proscribed by Birnbaum.

Since the decision below in the instant case, the Seventh Circuit issued its landmark opinion in Eason v. General Motors Acceptance Corporation, 490 F. 2d 654 (1973). [8] Whatever vitality the Birnbaum case had retained (other than its proscription of corporate mismanagement cases) was laid to rest by the Eason decision.

In Eason there did occur a sale of securities, but the parties to the sale were a defendant and another party. It was a securities transaction in which the plaintiffs were not participants. Plaitiffs were shareholders of Bank Service Corporation (not a party to the action), which issued 7,000 of its shares to defendant Waite in

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8 This court denied a writ of certiorari in Eason on April 22, 1974.

exchange for all of the assets of the latter company. As further consideration for the acquisition, BSC assumed all liabilities of Waite, including notes payable to GMAC. As part of the agreement, GMAC required and obtained personal guarantees of said notes by plaintiffs. BSC later defaulted on the notes and in a separate action GMAC sued plaintiffs on their guarantees. It was discovered, however, that both Waite and GMAC had made material misrepresentations concerning the true value of the former's assets and plaintiffs then brought this §10(b) action.

These facts show that the Eason plaintiffs were not purchasers or sellers, nor parties to a contract of purchase or sale, nor were they holders of a right which might be deemed an equivalent to a contractual right to purchase or sell securities. Nevertheless, they were granted standing under §10(b). Upon analyzing the Birnbaum decision and articulating its actual, limited holding, the Court in Eason suggests that the real

issue in determing the availability of §10(b) relief should not be one of "standing", but rather, whether plaintiffs are members of the class for whose special benefit Rule 10b-5 was adopted.

The Eason decision then established a test for determining whether a plaintiff comes within the intended class of protected persons:

> "Congress, the Supreme Court, and the [Securities Exchange] Commission have all used the term 'investors' to describe the class of persons protected by Rule 10b-5. Thus, the statutory authorization for the rule refers to the prohibition of deceptive devices 'for the protection of investors'." (Insert ours) 490 F. 2d at p. 659.

The court, however, does not suggest that the term "investors" be construed in the technical sense of a shareholder. "Investor" is defined in the opinion as someone who has a "stake"

or "interest" in the purity and outcome of a securities transaction.

> "The plaintiffs in this case were certainly 'investors' in the transaction which is allegedly tainted by fraud. Their interest as stockholders of Bank Service Corporation was apparently sufficient to induce them to execute substantial personal guarantees. As individual guarantors they were direct parties to the transaction in dispute. If, as plaintiffs have alleged, the transaction was consummated in violation of the Rule 10b-5, we believe the plaintiffs, as investors and as principals in the transaction, suffered a legal injury which may be redressed by a federal court." 490 F. 2d at pp. 659-660.

It is submitted that the plaintiffs in the pres-

ent case have no less an interest or stake in the securities transaction which is the subject of this action.[9]

In summary, respondent suggests that the conflict within the Circuits, which petitioners would have us believe would result by virtue of the decision below, is illusory. All of the cases cited by petitioners represent: (1) the unanimous trend in determining the purchaser-seller standing issue on a case by case basis and (2) the consensus of courts that mere internal corporate mismanagement is not a proper subject for a section 10(b) action. To deny standing under the facts and circumstances present here would be to exonerate from liability the petitioners because they were successful in their fraudulent scheme; that is, dissuading the offerees from exercising

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9 The court in Eason cited with approval the opinion below in the case at bar. See, 490 F. 2d at p. 660, footnote 25.

their "right" to purchase the mandatorily offered securities.

2. The Decision Below Does Not Deal With The Question Of Whether An Amicus Curiae May Enforce A Consent Decree, Nor With The Policy And Intent Of The Securities Act Of 1933.

The majority opinion below does not conflict with this Court's decision in United States v. Armour & Co., 402 U.S. 673 (1971), or other cases to the same effect. There is nothing expressed or implicit in the opinion which suggests that the plaintiffs herein may or are enforcing the Consent Decree in the anti-trust litigation.

The court's discussion of the Consent Decree serves as important historical background in understanding why the plaintiffs in the present case differ materially from any other interested investor. There is no suggestion in the opinion that plaintiffs are attempting to enforce the Consent Decree in a masked collateral proceeding or that they could ever do so. From that Con-

sent Decree, however, and the clear intent and purpose behind it flow the unique rights of the plaintiff-offerees. Had the court reasoned that plaintiffs were hereby enforcing the decree it would not have analogized their status as one which is the "functional equivalent" of a contractual relationship. If plaintiffs were enforcing or entitled to enforce the Consent Decree an actual contractual relationship would have been established. Such is not the import of the court's language.

The Armour case involved an attempt by the government to, in effect, modify a Consent Decree in order to protect against an evil which had not been anticipated at the time the Decree was entered. The court refused to go beyond the language of the Decree and adopt a construction that would "satisfy the purposes of one of the parties to it." (402 U.S. at p. 682.)

Specifically the court held:

" . . . the scope of a consent decree must be discerned within its four corners, and not by reference to what might satisfy the purposes of one of the parties to it." (402 U.S at p. 682.)

Contrary to the contentions of the petitioners, Armour does not suggest that a court may not take judicial notice of its own files and records in order to determine what is meant by certain language. The fact that the Reorganization Plan (R. at pp. 54-68) provides for an offering of 621,600 shares of new Blue Chip Stamps to "users" as opposed to the general public, that the new company would insure that these users would receive notice by advertisement of the proposed offering (R. at pp. 60, 67), and that any shares purchased by the users would not be transferrable lead one to inquiry regarding the uniqueness and intent behind such an offering. Furthermore, the Reorganization Plan, itself, refers

to the "right of the Users to prove their entitlement to units". (R. at pp. 67-68.)

Consequently, the court below properly examined the relevant documents in the anti-trust litigation in order to ascertain the relationship of the plaintiffs to the defendants in both that precdent case and in the present action. [10]

Because, as discussed above, plaintiffs are not attempting to enforce a Consent Decree, the petitioners' claim that a conflict has been created with reference to the decision in Data Proc. Fin. & Gen. Corp. v. International Bus. Mach. Corp., 430 F. 2d 1277 (8th Cir. 1970), is not well taken. Respondent agrees that a non-party may not directly and collaterally enforce a Consent Decree. No such attempt, however, is made in

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10 See Footnote 4 to the Opinion below (App. A of Petition at p. A-3) and cases cited therein.

the present case. An examination and analysis of the Consent Decree and the appurtenant documents thereto merely serve to explain and sustain the "right" or "entitlement" which the plaintiffs claim to have enjoyed (R. at pp. 7-8; App. E of Petition at p. E-9.)

The fact that the securities transaction that is the subject matter of the claim was mandated by the Consent Decree does not immunize the defendants from the statutes and rules regulating securities transactions. Plaintiffs herein rely upon a breach of duty imposed by these statutory anti-fraud provisions, not upon a breach of duty imposed by the Consent Decree. This is the argument used by the majority below in anticipating and dismissing the precise argument raised in the petition herein.[11]

Equally misplaced is petitioners' purported concern that the decision below presents the

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[11] See App. A of Petition at p. A-10, Footnote 14.

drafter of prospectuses with an "almost impossible task." (Petition at p. 24.) Respondent submits that it takes very strained reasoning or reaction to suggest the alarm which petitioners pretend with reference to the Opinion's alleged effect upon the duties required of future offerors. To suggest that the Opinion changes and undermines the purpose and policy of the Securities Act of 1933 is blatant alarmism in an attempt to convince this Court that it should grant review in the present case.

Respondent agrees that a requirement for disclosure of and emphasis on adverse matters "comports with Congress' purpose of protecting investors from issuers 'puffing' the value of their securities by minimizing the risks inherent in their purchase." (Petition at p. 23.) This policy deters those issuers who are overly enthusiastic about selling their securities. But there is nothing in that policy or in the language of the Act which licenses <u>over-emphasis</u>, as part of a fraud-

ulent scheme, of negative matters in order to dissuade sales. Unfortunately, this is the situation in the case at bar, peculiar as it may be. An issuer would clearly not be permitted to "puff" the negative aspects of an offer any more than it would be allowed to highlight its positive aspects.

No citation is necessary for the proposition that all that the 1933 Act requires is an honest and fair disclosure and presentation. If an issuer fraudulently fails to so, liability attaches under securities legislation and regulations, including section 10(b) where applicable. It is the duty of the trier of fact to determine whether an issuer has complied with the mandates of the Act and its regulations. Here, the complaint alleges that the defendants conspired to violate those mandates by deliberately over-emphasizing the negative "items of special interest" (R. at pp. 25 29 App. E of Petition at pp. E-10 to E-14). For purposes of this review, the allegations are deem-

ed to be true. At a trial of this case, it is the burden of the plaintiffs to establish that defendants have unduly over-emphasized the negative elements of the subject offer in furtherance of a fraudulent scheme.

If at trial plaintiffs prevail on that issue, then, and only then, is petitioners' concern about offeror's duties of disclosure under the Securities Act of 1933 potentially justiciable. Until such determination, however, the contention that issuers are now faced with an impossible burden is premature as is the claim that the decision below presents an important question of federal law which should be settled by this Court.

CONCLUSION

For the foregoing reasons the petition for a writ of certiorari should be denied.

Respectfully submitted,

J. J. BRANDLIN

Attorney for Respondent

Of Counsel:

JAMES E. RYAN
RAY E. McALLISTER

October,

SUMMARY OR ARGUMENT

The facts in the instant case present a unique circumstance in Section 10(b) litigation in that the plaintiffs, while technically not purchasers or sellers, owned a "right" to purchase the securities offered by defendant. That "right" served as the functional equivalent of a contractual relationship, a basis upon which Courts have historically granted standing under §10(b). Because of this unique right and the facts peculiar to this case, the decision below has singular application to the case at bar and, as so distinguished, does not conflict with decisions of other Circuits.

Moreover, the cases cited by petitioners as allegedly representing a contrary view on the issue of standing all have in common factual situations whereby there is either an attempt by shareholders to use §10(b) as a vehicle of redress for internal corporate mismanagement or the claim by a party that it has suffered a loss as

a result of fraud in connection with the sale of a security by the defendant to a third party. Neither of these factual situations or claims is presented herein.

The Opinion below does not hold, even implicitly, that respondent is entitled or is even attempting to enforce an anti-trust Consent Decree. Nor does the decision present an important question of law concerning the disclosure duties of an issuer under the Securities Act of 1933. Not only does the Opinion not raise such an issue, that question would not be justiciable until there had been a trial on the merits.

APPENDIX A

Appendix A

UNITED STATES COURT OF APPEALS

FOR THE NINTH SIRCUIT

[Filed August 15, 1972]

MANOR DRUG STORES, On Behalf of Itself and All Other Users of Blue Chip Stamps Who Were Entitled But Failed to Purchase Stock of Blue Chip Stamps. Plaintiff-Appellant, vs. BLUE CHIP STAMPS, BLUE CHIP STAMP COMPANY, LUCKY STORES, INC., MARKET BASKET, PURITY STORES, INC., RALPHS GROCERY COMPANY, SAFEWAY STORES, INC., THRIFTIMART, INC., THRIFTY DRUG STORES CO, INC., VON'S GROCERY CO., ROBERT E. ALEXANDER, DONALD A. KOEPPEL, LEONARD M. STRAUS, WILLIAM F. RAMSEY, ROBERT E. LAVERTY, RICHARD RALPHS, JOHN R. NIVEN, FRED VON DER AHE, Defendants-Appellees.	No. 71-2223 PLAINTIFF-APPELLANT'S SUPPLEMENTAL BRIEF

I. PRELIMINARY STATEMENT

In response to the Court's order, plaintiff-appellant herewith submits its brief regarding the recent Ninth Circuit decision in Mount Clemens Industries, Inc. vs. Bell, No. 71-1318, decided June 28, 1972. The Securities Exchange Commission, which has appeared heretofore in this proceeding as amicus curiae, has has likewise been requested to file a brief. It is plaintiff-appellant's understanding from conversations with Securities Exchange Commission's counsel that their brief will primarily urge that the Mount Clemens decision be rejected in toto by this Court. While we join in the brief of the Securities Exchange Commission and the arguments raised therein, at the same time we feel that the

Mount Clemens case supports the position that has been consistently urged by plaintiff-appellant herein. Although we feel that the Mount Clemens case and the one at bar present dissimilar facts and therefore necessarily different questions before the Court, we nevertheless fell that much of the language of the Mount Clemens opinion and the crux of the rationale support and affirm this plaintiff-appellant's contentions.

Although we share in the Security Exchange Commission's disappointment over the Court's refusal to disaffirm the Birnbaum doctrine in toto, we do not find the Mount Clemens decision to be a hindrance in any other respect. The Mount Clemens case is easily distinguished from the one at bar. There, certain corporate securities were offered at an ordinary public auction. Plaintiffs were merely members of the general public interested in purchasing the subject securities. Defendant represented to the plaintiffs that the securities were worthless and it is alleged that the plaintiffs were thereby induced not to bid at the sale. There was no allegation by the plaintiffs that they enjoyed any status or had any special rights other than that of all other members of the public. There was no previous relationship between the parties which gave rise to any duty on the part of the defendant or any "right" on behalf of the plaintiffs to engage in the securities transaction. The Court in Mount Clemens made the following observation which we contend to be of significant importance:

> "Plaintiffs were not even induced to refrain from accepting an outstanding offer" (emphasis ours)(Slip. Op. at page 10 , footnote 11.)

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The gravamen of the amended complaint in the present case concerns and alleges the very existence of an outstanding offer. (Amended Complaint, paragraph XVI, R.13) Additionally, it is alleged in our Amended Complaint that the "Users" herein enjoyed a unique status, which status "Prompted The Plan and the offering." (Amended Complaint, paragraph X, R.6-7, 1.28)

We contend, therefore, that the crucial question before this Court is whether or not the plaintiffs-appellants herein possessed a special and exclusive right or owned an equitable interest within the protective provisions of Section 10(b). If the Court concludes that the complaint does not allege with sufficient clarity the special right of plaintiff's to purchase the offered stock, plaintiffs ask leave to amend the complaint to conform to the following facts.[1]

In light of certain of the language in the Mount Clemens decision and by virtue of certain deductions the undersigned has made as a result of the Court's questions at the time of oral argument of this matter, this brief will be limited to an elucidation of the status of the plaintiff-appellant at the time of the subject violation of Section 10(b).

II. THE MOUNT CLEMENS DECISION SUPPORTS PLAINTIFF-APPELLANT'S CONTENTION THAT IT HAS "STANDING" UNDER SECTION 10(b) OF THE SECURITIES EXCHANGE ACT OF 1934

Initially, it must be noted with much importance that the Mount Clemens opinion specifically adopts the view which has been persistently urged by plaintiff-appellant throughout these proceedings, to wit: that a plaintiff is not dependent upon an actual purchase or sale in order to state a cause of action under

1. ... (T)he accepted rule (is) that a complaint should not be

Section 10(b). Specifically, the Court stated:

> "These allegations clearly reveal that plaintiff never actually purchased or sold the Missile stock. Yet that circumstance does not end our inquiry, for under the liberal interpretation that has sometimes attended the application of the Birnbaum Doctrine there have been cases in which standing has been afforded to persons who, even though not actual purchasers or sellers, have been deemed to have the required status. (citing cases)" (Slip. Op. at page 9)

Consequently, the Mount Clemens decision lays to rest a major issue regarding which both appellant and appellee devoted much of their previous briefs. Therefore, despite defendants-appelles' repeated arguments to the contrary, the amended complaint herein is not defective because it admittedly asserts that the "Users" were non-purchasers.

There can also be no question that the Mount Clemens decision holds that lacking the status of an actual purchaser or seller the plaintiff must demonstrate that it enjoys some other status for which relief should be afforded. The Court recognized that all of the cases which adopted the non-technical or liberal interpretation of the 10(b) standing language found that the plaintiff enjoyed the status of "a party to a prior agreement to purchase or sell" securities. The Mount Clemens Court observed

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dismissed for failure to state a claim unless it appears beyond a reasonable doubt that the plaintiff can prove no set of factors in support of his claim which would entitled him to relief." Conley vs. Gibson (1957), 355 U.S. 41, 46, 78 S.Ct. 99, 102, 2L.Ed. 2d 80.

that the cases which fall into the "aborted purchaser-seller cases" ((Opper vs. Hancock Secs. Corp., 367 F.2d 157 (2d Cir.), Aff'g. 250 F.Supp. 668 (S.D.N.Y. 1968); Goodman vs. H. Hentz & Co., 265 F. Supp. 440 (N.D.Ill. 1967); Stockwell vs. Reynolds & Co., 252 F.Supp. 215 (S.D.N.Y. 1965)) all presented evidence of such a prior agreement or "contractual relationship". At the same time, the Court noted:

> "We recognize that the term 'contract' in Sections 3(a) (13) and 3(a) (14) must be given a broad, liberal interpretation (citing cases). (Slip Op. at page 11 , footnote 12.

As is obvious from the very title of the category of such cases, each of the plaintiffs in the "aborted purchaser-seller" cases was frustrated from consummating a specific purchase or sale of securities. The courts, of course, did not deny these plaintiffs relief merely because they were never able to engage in the particular securities transaction. Rather, they were afforded standing under Section 10(b) because they had a right to participate in the transaction in question. In those cases above cited, the rights of the plaintiffs flowed from an agreement or a contract. We submit that the plaintiff-appellant herein similarly had a right to engage in a specific transaction. That right emanates from a court decree, based upon a stipulation (contract) in the government anti-trust case. The decree singled out the plaintiffs ("Users") and gave them a special right, distinct, unique and exclusive from the "man on the street" plaintiff in the Mount Clemens case.

We wish, therefore, to present to this Court the following historical, legal data which is the font of this entire litigation

and from which flowed the status of the plaintiff-appellant ("Users"). We therefore request that this Court take judicial notice of those citations and quotations from the record of the previous anit-trust lawsuit.[2]

III. THE RECORDS AND PLEADINGS OF THE GOVERNMENT ANTI-TRUST SUIT ESTABLISH THAT "USERS" HAD A "RIGHT" TO PURCHASE BLUE CHIP STAMP'S SECURITIES

As is alleged in the Amended Complaint(R.4-6) and has been briefed and argued in these proceedings, the basis of plaintiff-appellant's claim under Section 10(b) stems from the Consent Decree entered June 5, 1967 by the United States District Court in United States of America vs. Blue Chip Stamp Company, et al., No. 63-1552. This was a civil anti-trust action in which it was alleged in substance that the defendants had conspired to restrain competition in the trading stamp industry in California and had obtained an illegal monopoly therein. A chronological history of that litigation establishes the genesis of the "Users'" "rights" herein and the total fallacy in the defendants' contention that the "Users" had no more than an "opportunity" to purchase the securities in question.

The records in that case reveal that:

On July 29, 1966, the United States Government as plaintiff and all but two of the defendants therein agreed to and lodged with the Court a proposed consent decree. Said decree made no provision concerning any offering of securities to "Users"; nor was there any mention or recognition of said "Users".

The two non-consenting defendants were Thriftimart, Inc. and Market Basket. They were most adamant in their refusal to stipulate to the proposed consent decree and urged that the

2. Federal Appellate Court may take judicial notice of matters,

implications of any such decree would have a tremendous impact on the grocery and other retail industries in California which subscribed to Blue Chip's stamp program and the very economy of California in general. Thriftimart therefore petitioned the Court that the "retail customers" of Blue Chip be brought into the action as indispensable parties plaintiff or parties defendant (Motion of Thriftimart, Inc. For Order Re Proposed Final Judgment By Stipulation, filed July 29, 1966.)

The Court thereupon permitted the entry into the case by various amici curiae, among which was the Attorney General of the State of California. The Attorney General entered his appearance on behalf of all retail grocers of California who were non-defendants and in his capacity as parens patriae. (Amended Complaint, paragraph IX, R.23) The above-mentioned retail grocers therefore included a large number of the plaintiff-"Users" herein. On September 27, 1966, the California Attorney General filed his brief in opposition to the entry of the first proposed consent decree. Therein he stated:

> "It should be borne in mind that, in organizing Blue Chip, in their capacity as majority stockholders and promotors [sic] the defendant retailers caused it to be reported to the retail grocers of the State that Blue Chip would be non-profit to those who promoted it. It was in reliance upon such representation that several thousand retail grocers, not defendants in these proceeding, gave their

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even though not brought to the attention of the lower court, where necessary to show the impropriety of the lower court decision. International Brotherhood of Teamsters, Chauffers, Warehousemen and and Helpers of America vs. Canton Air Transport Corp., 394 F.2d 50 (6th Cir. 1968)

patronage to Blue Chip, and gave it to such an extent that in the aggregate they accounted for not less than 2/3 of the patronage Blue Chip enjoyed during the ten years of its existence. In point of fact, Blue Chip has been operated without profit to its stockholders as such. Consequently, and with fairness to all, Blue Chip's present net assets, tangible and intangible over and above the paid-up value of its share of stock, should be regarded as beneficially belonging to the retail grocers who made it what it is today." (emphasis ours) (Brief of the State of California As Amicus Curiae, p.42, ll.19-31, p.43,ll.1-4, filed September 27, 1966)

On October 3, 1966, the government-plaintiff withdrew its approval of the proposed consent decree.

On October 28, 1966, a second proposed consent decree was lodged with the Court. This decree was substantially the same as its predecessor and again contained no provision for an offering of securities to non-defendant "Users" or otherwise any mention or recognition of that class. On October 28, 1966 by its Order of same date, the Court instructed defendants and amici curiae to file objections to the second proposed consent decree.

On November 15, 1966, the State Attorney General filed its brief objecting to the proposed decree. Again he objected to the decree's failure to recognize the beneficial or equitable interest of the non-defendant "Users":

"Blue Chip's present net assets, tangible and

intangible, over and above the paid-up value of its shares of stock, should be regarded as beneficially belonging, in proportion to their patronage, to all the retailers who made it what it is today." (Brief Of The State Of California As Amicus Curiae, p.77, ll.8-12, filed November 15, 1966)

As an appendix to his brief, the Attorney General submitted a proposed consent decree which provided that upon dissolution of Blue Chip Stamp Company there be a distribution of its assets on a pro rata basis to the non-defendant "Users".

Also appearing in an amicus curiae stature were, jointly, the California Grocers Association and Certified Grocers of California, Ltd.. On December 5, 1966, they filed their brief in opposition to the second proposed consent decree and after tracing the origin and development of the Blue Chip Stamp Company and the representations which had been made to the non-defendant "Users", urged the Court:

"Out of this abundance of successful cooperative experience, the independent retailers of California believe that Blue Chip Stamp Company should be controlled and owned by the users, directly or indirectly." (emphasis ours) (Memorandum On Behalf Of California Grocers Association And Certified Grocers Of California, Ltd., As Amicus Curiae, p.37, ll.19-22, filed November 14, 1966)

Thriftimart, Inc. once again objected and filed its brief in opposition to the second proposed decree. Reiterating its

concern that the "Users" be joined as indispensable parties, Thriftimart in support of its contentions noted the aforementioned claims by the amici curiae:

> "As a result of this position, Certified Grocers and the California Grocers Association have taken the position that the assets of Blue Chip are held in trust for the users to the extent which these representations warrant." (emphasis ours) (Objections And Opposition (Of Thriftimart, Inc.) To Entry Of Second Proposed Consent Decree, Lodged October 28, 1966.)

The government-plaintiff and the consenting defendants filed briefs in response to the foregoing memoranda and, in general, urged that the proposed decree was fair and equitable to all concerned and that there was no just reason for delay in its entry.

A reply brief by California Grocers Association and Certified Grocers of California, Ltd. commented upon the plaintiff's and defendants' briefs and further emphasized the unrewarded claim of the non-defendant "Users":

> "From its inception, Blue Chip was promoted as being run for the benefit of the users whose help was enlisted in its promotion.
>
> "The consenting parties have not addressed any comments to this point. However, much as they would, they cannot close their eyes to the role of the non-defendant users and their very real equity in Blue Chip, its name, its good will and the value of its established business.

"The rights of thousands of California merchants relate not only to the unpaid patronage dividends but also to the other more valuable assets of Blue Chip. So long as any settlement of this case fails to recognize these rights of non-defendant users, the required determination that such settlement is equitable and in the public interest cannot be made." (emphasis ours) (Reply Brief Of California Grocers Association And Certified Grocers Of California, Ltd., As Amicus Curiae, pp.12-13, filed December 5, 1966)

Thriftimart, Inc., also replied to the briefs of the plaintiff and the consenting defendants in support of the second proposed consent decree, and although a defendant in the case at bar, it would appear from the following language of its brief that Thriftimart fully aligned itself with the "Users":

"Equally important, if not more important, is the fact that the consenting defendants cannot destroy the Blue Chip Stamp Company through the means of the Consent Decree without being guilty of fraud with respect to all of the grocers who relied upon their representations at the organization of Blue Chip and which representations were made repeatedly throughout the years to the present time.

"The grocers relied on these representations and acquired to the extent of their reliance and the extent of the representations an equitable interest

in the business of Blue Chip as equitable members of a de facto co-operative." (emphasis ours) (Reply Of Defendant Thriftimart, Inc. To Argument Of The Sperry And Hutchinson Company, Plaintiff And The Consenting Defendants, p.19, ll.22-32, filed December 6, 1966)

Thriftimart went on to state:

"It was on the basis of these representation oft repeated that the grocers of California came into the Blue Chip plan in order that they might remain competitive with those having the Sperry and Hutchinson franchised S & H green stamp. All went into the program. They made it a success. It was the money of the members as much as the backing of the stockholders that made possible Blue Chip and saved the grocery industry from monopoly. These facts, among others, are the background for the position of Certified Grocers and the California Grocers Association that they have a beneficial interest in this company. (emphasis ours) (Reply Of Defendant Thriftimart, Inc. To Argument Of The Sperry And Hutchinson Company, Plaintiff And The Consenting Defendants, p.24, ll.6-15, filed December 6, 1966)

After three days of oral argument, the Court refused to enter the second proposed consent decree. (Court Minutes of December 15, 1966) There can be no doubt as to Judge Ferguson's reasons for declining to sign the decree as is evidenced by his

following statement in a hearing on objections to a third proposed donsent decree:

"THE COURT: I have read it (third proposed consent decree) hundreds of times. Please don't make me go through it again.

"Answer my question, as a pragmatic service station operator, if you can convince me that this decree is going to do injury to you I probably won't sign it. But you are going to have to convince me on that level.

"MR. DOWNS: That's right.

"THE COURT: The grocery store people convinced me last time. Now if you, as a service station operator, can convince me this time more power to you. But you are not going to convince me on any other kind of approach." (insert and emphasis ours) (Reporter's Transcript of Proceedings of June 5, 1967, p.466 11.5-17)

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"THE COURT: There is a difference, there is a difference. Mr. Howland (Assistant State Attorney General) convinced me last time about the grocery stores." (insert and emphasis ours) (Reporter's Transcript of Proceedings of June 5, 1967, p.477, 11.12-14)

On April 28, 1967 a third proposed consent decree was lodged with the Court. This, of course, was the Consent Decree which was eventually signed on June 5, 1967 and thereafter put into

operation. (Amended Complaint, paragraph VI, R.4) It was pursuant to paragraph V of said Consent Decree (R.22), in which the defendants were ordered to present to the Court within 60 days a plan of reorganization of Blue Chip Stamp Company, that the defendants filed and had approved the plan of reorganization (R.35) containing the offer to "Users".

All of the parties and aforementioned amici curiae approved the Consent Decree. Certain other amici curiae objected to it (e.g. Independent California Service Station Operators, Gold Bond Stamps, etc.). In reply to their objections, the plaintiff-government commented on the considerations which had been involved in drafting the third proposed consent decree:

> "The proposed Final Judgment lodged with the Court on April 28, 1967 was agreed to by the United States only after long and complicated negotiations extending over two years. In drafting this decree, earnest consideration was given to the views of the Court expressed on December 15, 1966. Oral and written views of counsel for defendants, the State of California, Certified Grocers' Association, and the California Grocers' Association, all of whom approve the proposed decree, were received and considered by the Department of Justice, as well as the views of all parties interested in opposing the decree. (Plaintiff's Memorandum In Reply To Memorandum Filed In Opposition To Proposed Final Judgment Lodged With The Court April 28, 1967, p.5, ll.12-21, filed May 26, 1967)

In seeking Court approval of the Reorganization Plan and in defense of their "bargain offering" to "Users", the defendants stated:

> "...The Reorganization Plan has two basic purposes and objectives, namely: (1) To divest control of the company by the present stockholders and broaden the base of ownership so as to dissipate the alleged (and denied) combination and restraint, and (2) to compromise disputed claims which had been asserted by representatives of California Grocers' Association, Certified Grocers, and others in behalf of non-stockholder users. While the existence of such an equitable interest has been denied, it can fairly be said that the claims which had been so asserted were such that the Board of Directors of Blue Chip could properly and in good faith determine that they were worthy of being compromised." (emphasis ours) (Reply To Memorandum Of Raley's Inc. In Opposition To Motion Of Defendants For An Order Approving The Plan Of Reorganization Of Blue Chip Stamp Company Lodged With The Court August 3, 1967, p.9, ll.3-17, filed August 22, 1967)

If it is not clear from the above, it is manifestly so from the following, that the present defendants recognized the "right" or equitable interest of the "Users" and incorporated them into the plan of reorganization and Consent Decree:

> "There is the additional fact that a valuable

consideration moved from the Blue Chip shareholders to present Blue Chip which fully justifies its agreement to protect its shareholders, officers, and directors from liability. Certainly, it was and is in the interest of Blue Chip to settle the Government action without trial. It became apparent that such settlement could not be achieved without offering non-stockholder users an opportunity to acquire an equity interest at a price substantially equivalent to that originally paid by the present stockholders." (emphasis ours) (Reply To Memorandum Of Raley's Inc. In Opposition To Motion Of Defendants For An Order Approving The Plan Of Reorganization Of Blue Chip Stamp Company Lodged With The Court August 3, 1967, p.7, ll.7-18, filed August 22; 1967)

If there be any doubt that the Court, too, recognized this equitable interest in the "Users" and intended that it be accounted for in the Consent Decree, such doubt is allayed by the Court's following statement:

"The decree herein is designed to limit the powers of Blue Chip and to open up and increase competition in the stamp industry in California, while at the same time preserving the legitimate interests of the users of Blue Chip Stamps." (emphasis ours) (Order Denying Motions To Intervene And To Vacate Consent Decree, p.18, ll.6-10, entered August 8, 1967)

In addition, the very fact that the offering of securities to the "Users" was at a bargain price compels the conclusion that

the defendants recognized that the "Users" possessed the claimed equitable interest or right. Despite defendants' contentions to the contrary, there is no question, as well be seen infra, that the offering to the "Users" was intended to be and was, in fact, at a bargain".

In a hearing subsequent to Court approval of the Consent Decree and Plan of Reorganization, Mr. William W. Alsup on behalf of Blue Chip Stamps conceded that the "Users" were intended to be benefitted by the Consent Decree and plan of reorganization thereunder:

> "Mr. ALSUP: We do think we need a hearing date obviously to go into the question of who of these users are entitled to subscribe, assuming Mr. Raley and his group are not, and we take care of these users, as was intended." (emphasis ours) (Reporter's Transcript Of Proceedings, Monday November 4, 1968, Thursday, November 7, 1968, p.12, ll.8-12)

Furthermore, it was conceded that the offering was to be of substantial benefit to the "Users":

> "In our reply filed August 22, 1967 to the memorandum in opposition of Independent California Service Station Operators we discussed the financing arrangements available through the Bank of America and stated in part:
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> ***
>
> "'If the service station operators are, even remotely, as unsophisticated financially as counsel

suggests, then if subscription rights were transferable there could be considerable danger they could be persuaded to give up their right to subscribe for a grossly inadequate price.

"'Certainly there is nothing illegal in restricting transferability of a rights offering and, since there is no restraint on the stock itself there is no restraint on alienation of property, i.e., the stock and debentures.

"'We cannot agree that the service station operators could be so lacking in time and financial sophistication that they will be unable to make a bank loan, and particularly so on an offering which it is conceded will be of substantial benefit to them.'" (emphasis ours) (Memorandum Of Blue Chip Stamps In Support Of Contention That The Raley's Options And Assignments Should Be Declared Invalid, pp.4-5, filed November 7, 1968)

The other party-litigant in the anti-trust litigation, the United States Government, through its counsel, Stanley E. Disney, Assistant U.S. Attorney, agreed with the assessment that the offering was a "bargain":

"MR. DISNEY: But on the basis of the record as it stands I think that many small users had made bad bargains and if there is any way to -- and I think that we intended in the decree to see that they got a good bargain." (emphasis ours)

(Reporter's Transcript Of Proceedings, Monday, November 4, 1968, Thursday, November 7, 1968, p.88, ll.1-4)

Again Mr. Disney pointed out the "bargain" aspect of the offering:

"MR. DISNEY: With reference to the decree, the intent of the decree he said that distributing 45% of the shares to users was intended basically to achieve two purposes. First to give the user the shares at bargain prices and hope that they would retain those shares; and secondly, by having a widespread distribution of the shares among the users to entrance the method in which the first and most important meeting of shareholders of Blue Chip Stamp took place." (emphasis ours) (Reporter's Transcript of Proceedings, supra, p.78, ll.9-17.)

At the same hearing, Mr. Wallace Howland on behalf of the State Attorney General sounded almost as if he had the present litigation in mind when he addressed the Court as follows:

"MR. HOWLAND: What we have here is a provision in the plan of reorganization that created and brought into existence a right or entitlement in the users of Blue Chip Stamps.

***

"And to make sure that the users knew of this right and entitlement there had been conferred upon them by the order of this court, the plan

then required advertisements in newspapers, and that a form on which the user could establish his usage would be sent out to all users, and that thirty days after the publication of the first such advertisement the right of users to establish their usage shall terminate.

***

"So what we have here, if the court please, is a right, a legally cognizable right conferred upon the user by the plan of reorganization proved by order of this court. It was a right, in effect, to compel Blue Chip Stamp Company to issue its units to a user, and it was a right that each user could either exercise or waive in his discretion." (emphasis ours) (Reporter's Transcript, supra, pp.41-43)

III. CONCLUSION

We therefore submit that it is clear from the foregoing exposition that: the "Users" emphatically asserted in the anti-trust action an equitable interest or right, that interest or right was recognized by the Court, the defendants, the government-plaintiff, and the various amici curiae on behalf of the "users," that interest or right was intended to be and was in fact incorporated in the Consent Decree and Plan of Reorganization thereunder, and that the "Users" must be afforded the appropriate relief under Section 10(b) in protection of that interest or right.

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Thus, we respectfully request that this Court reverse the Order below and permit this matter to be heard on its merits.

Respectfully submitted,

Dated: August 15, 1972

Brandlin, Ryan & McAllister

By: /s/ James E. Ryan
James E. Ryan

Attorneys For Plaintiff-Appellant

AFFIDAVIT OF SERVICE BY MAIL

STATE OF CALIFORNIA)
) ss.
COUNTY OF LOS ANGELES)

MARSHA JONES, being duly sworn, deposes and says: that her business address is 10960 Wilshire Boulevard, Los Angeles, California 90024; that she is a citizen of the United State and over the age of 18, employed in the County of Los Angeles, California, and not a party to this cause; that on August 15, 1972 she served a copy of the Supplemental Brief on the following parties:

O'Melveny & Myers
Attn: Thomas J. Ready
611 West Sixth Street
Los Angeles, California

McCutchen, Black, Verleger & Shay
Attn: G. Richard Doty
3435 Wilshire Boulevard
Los Angeles, California

Securities Exchange Commission
Jerry W. Markham
Washington, D.C.

Said service was accomplished by depositing a copy of said Affidavit enclosed in a sealed envelope, addressed to each party with the postage thereon fully prepaid, in a mailbox regularly maintained by the Government of the United States at 10960 Wilshire Boulevard, Los Angeles, California 90024.

Marsha Jones

Subscribed and sworn to
before me this 15th day of August, 1972.

Notary Public in and for said County and State

OFFICIAL SEAL
ROYCE IRVE UNDERWOOD
NOTARY PUBLIC-CALIFORNIA
PRINCIPAL OFFICE IN
LOS ANGELES COUNTY
My Commission Expires July 21, 1975

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